

The logo features the text 'fi360' in a serif font, with 'fi' in black and '360' in orange. Below it, the words 'global' and 'fiduciary insights' are written in a smaller, italicized serif font. The background is a warm orange-to-yellow gradient with several wavy, horizontal lines in shades of orange and yellow, creating a sense of movement and depth. The top right corner of the image is rounded.

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The Fiscal Cliff and What Advisors Need to Know

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All opinions expressed are my own and do not reflect those of the Financial Planning Association

Spending Cuts

- \$110 billion in spending cuts in 2013 required by Budget Control Act of 2011
 - \$55 billion from defense
 - \$55 billion from nondefense
- Expiration of Unemployment Benefits (\$26 billion)

Tax Increases >\$500 Billion in 2013 alone

- \$166B 2001/03 tax cuts
- \$ 13B estate tax at 35%, \$5m
- \$ 119B AMT patch
- \$ 64 Tax Extenders
- \$125 Payroll Tax Holiday
- \$ 29 Tax Stimulus
- \$ 22 Tax Increases in Healthcare Reform

CBO: **1.3% contraction of GDP** in H:1 2013 if no changes made to current law.

- Lose 10% Income Tax Bracket. Lowest rate 15%.
- Higher Income Tax Brackets.
 - 25 -> 28%
 - 28 -> 34
 - 33 -> 36
 - 35 -> 39.6
- Child Tax Credit shrinks from \$1,000 to \$500 per child
- Reduced Education Savings Incentive
 - American Opportunity tax credit
 - \$2,500/student for first 4 years of college reduced to \$2,000/student for first 2 years of college & lower phaseout
 - Coverdell ESAs
 - \$2,000 -> \$500 per student & lower phaseout



Fiscal Cliff and What Advisors Need to Know

Tax Increases: Expiration of 2001 & 2003 cuts

- Capital Gains 15% -> 20%
- Dividends 15% -> marginal income tax rate
- Phaseout of itemized deductions (Pease)
3% of AGI over threshold (est \$174,450); capped at 80% maximum
- Personal Exemption Phaseout (PEP)
2% reduction in exemption for each \$2,500 that AGI exceeds threshold
(est \$262,650)

- Estate Tax modified December 2010
 - \$5.12 million exemption -> \$1 million
 - 35% rate -> Graduated rate 41% to 55%
 - +5% surtax estates b/t \$10 and \$17.184 million

Spousal Portability of unused exemption

Expiration \$250,000 home sale gain exclusion for qualified revocable trusts



- Alternative Minimum Tax (AMT)
Exemption \$74,450 MFJ (\$48,450 Single) -> \$45,000 (\$33,750)
- A few of the Tax “extenders”:
 - Deductibility of state and local sales taxes
 - Tax-free rollover or minimum required distributions to charities
 - Parity for employer-provided mass transit benefits
 - 15-year straight-line depreciation for leasehold improvements

- Payroll Tax Cut
Payroll withholding increases from 4.2% -> 6.2%
- 50% Bonus Depreciation expires
- Expanded Small Business Deduction (Section 179)
Annual limit \$139,000 -> \$25,000
Phaseout \$560,000 -> \$200,000

Effective January 1, 2013

- Surtaxes on High Income Individuals (AGI > \$200,000 /\$250,000 MFJ)
 - +0.9% addition tax on **earned income**
 - +3.8% additional tax on **unearned income**
- FSAs limited to \$2,500 annually
- Medical expense deductions threshold 7.5% -> 10% AGI (except seniors)
- **Less likely to be delayed**

What's Going to Happen?

Status Quo

Obama
Democratic Senate
Republican House

Split-Republic Congress

Obama
Republican Senate
Republican House

Republican Sweep

Romney
Republican Senate
Republican House

Split-Mixed Congress

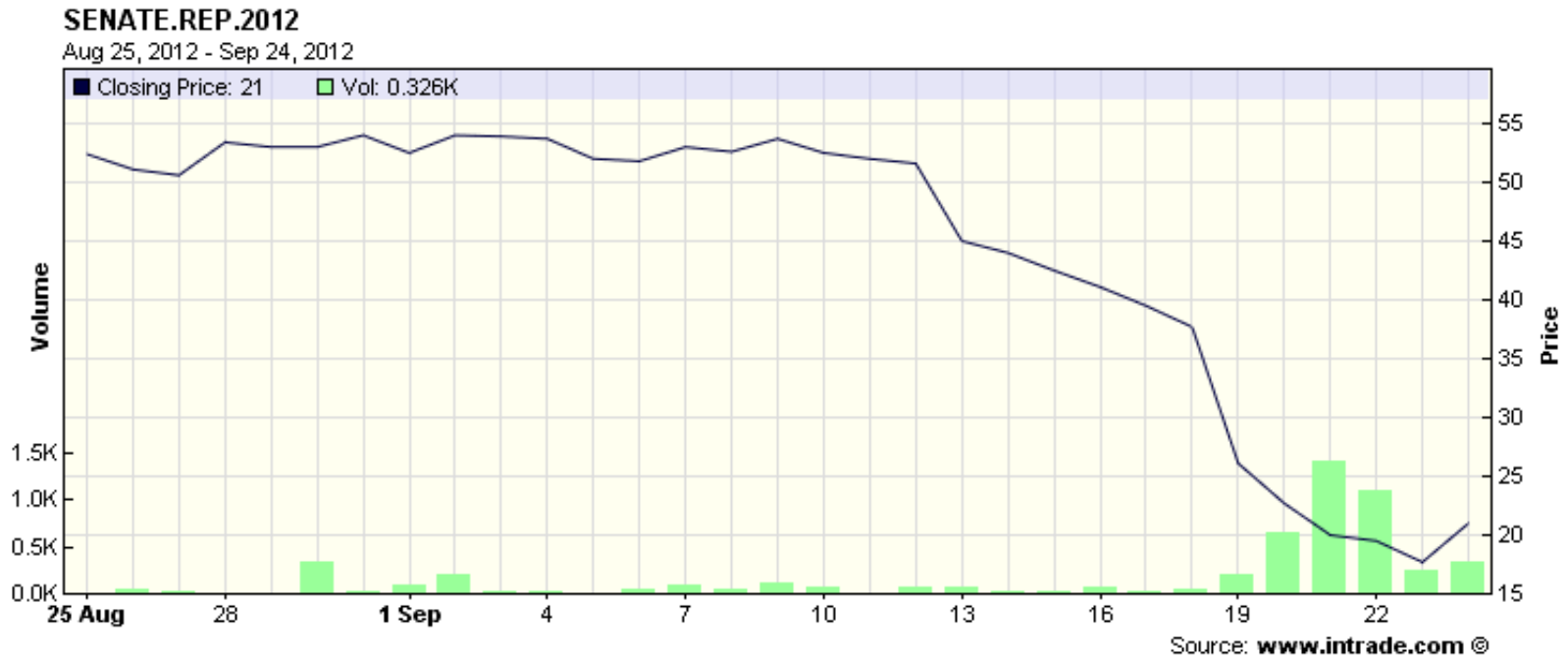
Romney
Democratic Senate
Republican House

Democratic Sweep

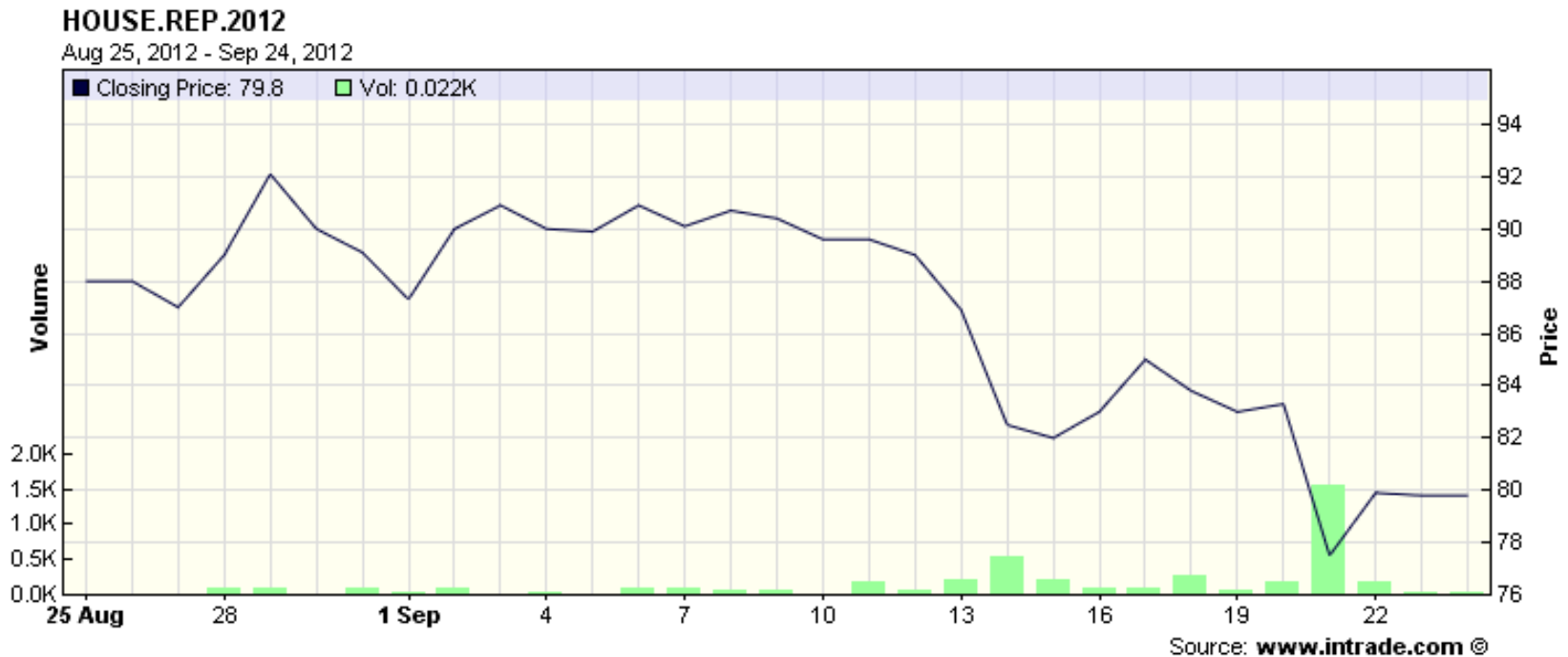
Obama
Democratic Senate
Democratic House



Price = Probability 72% chance reelection



Price = Probability 20% chance R's take Senate



Price = Probability 80% chance R's keep House

Most likely outcome...

Status Quo

Obama

Democratic Senate

Republican House



Lame Duck Session of Congress
Thanksgiving to December 31

Time for a Grand Compromise?

Forestall Fiscal Cliff?

- 2001/2003 tax cuts
- AMT & most tax extenders
- Estate and Gift
- Tax Stimulus
- Healthcare surtaxes

More gridlock?

Next Congress

Weak Economic Growth; Persistently High Unemployment

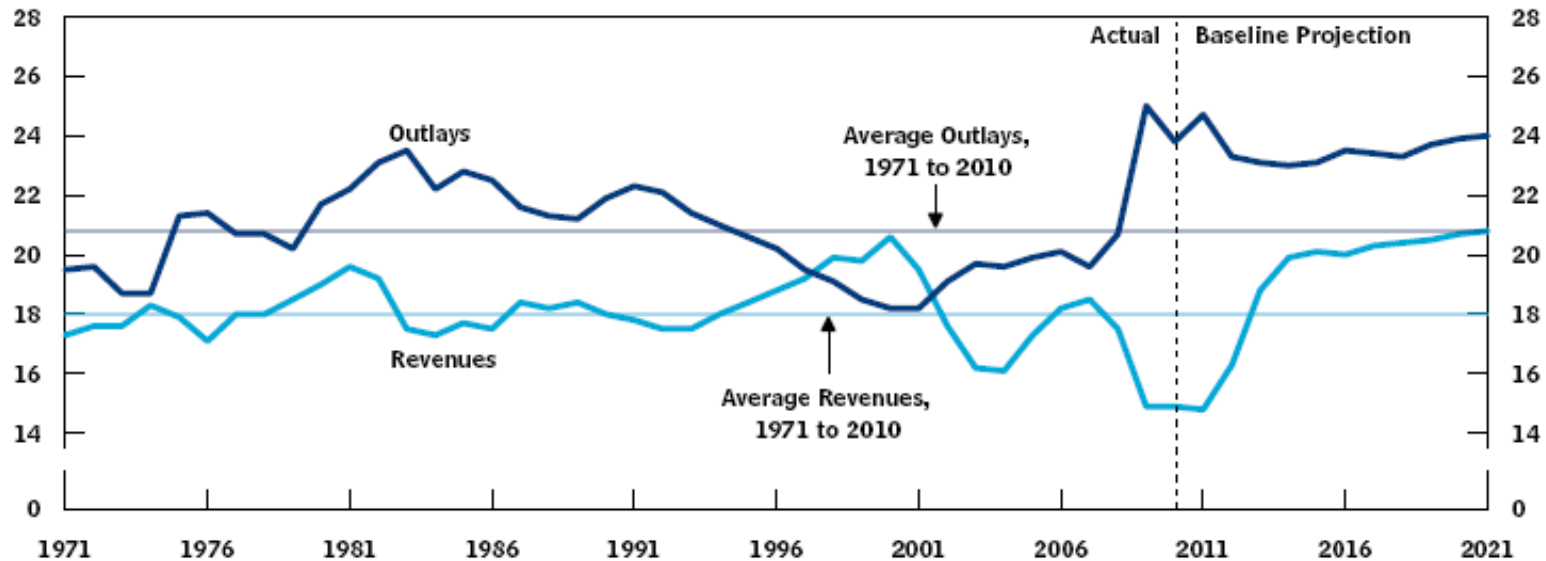
Budget Issues

Debt Ceiling

Tax Reform – the big wild card

Total Revenues and Outlays, 1971 to 2021

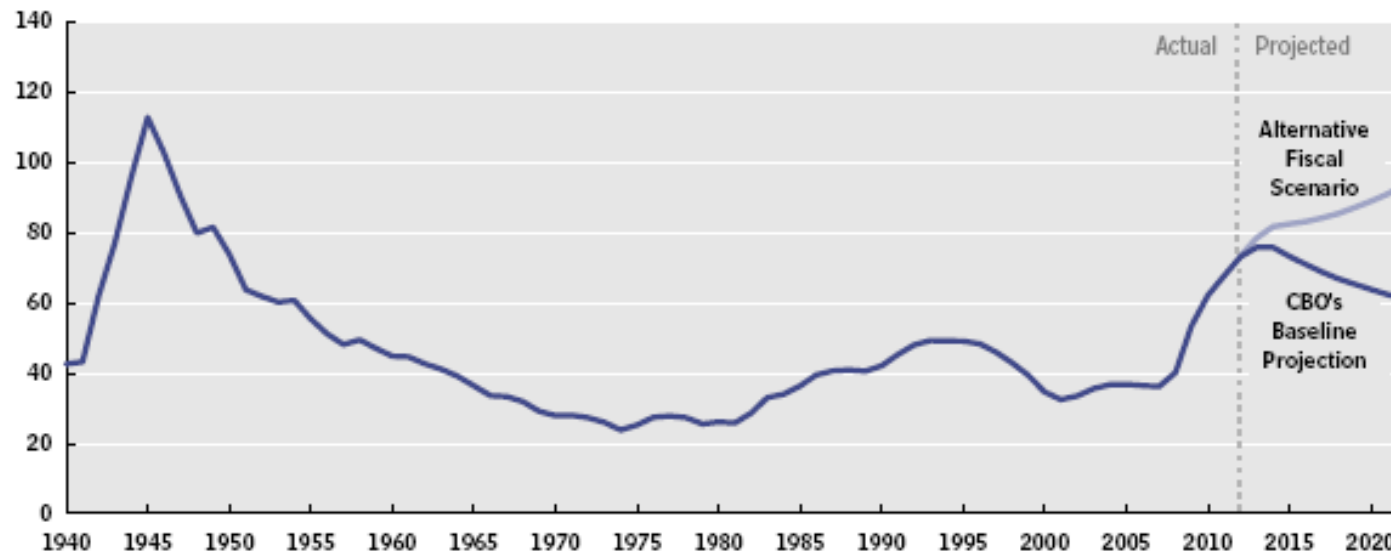
(Percentage of gross domestic product)



Source: Congressional Budget Office (as of January 2011).

Federal Debt Held by the Public Projected in CBO's Baseline and Under an Alternative Fiscal Scenario

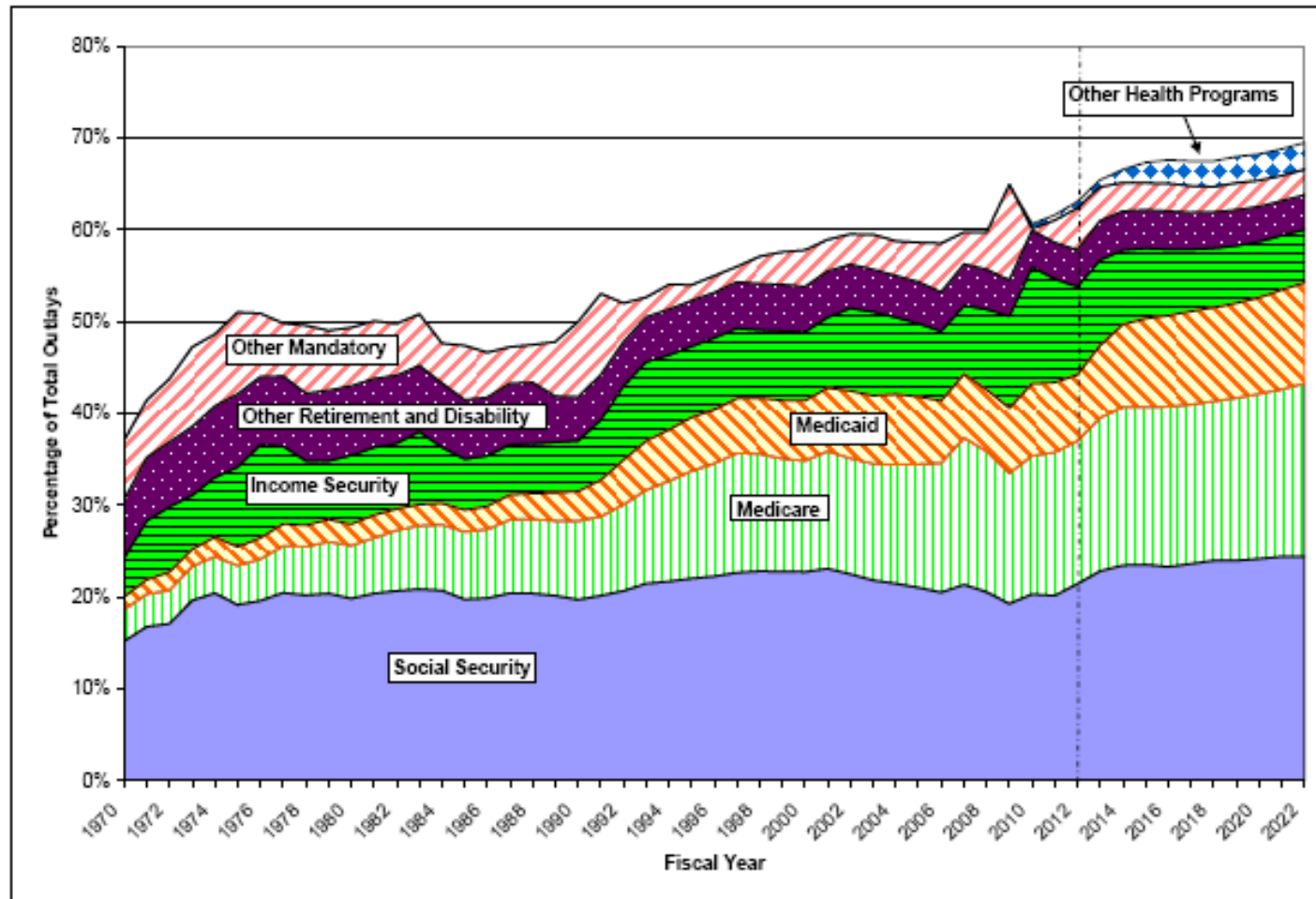
(Percentage of gross domestic product)



Source: Congressional Budget Office.

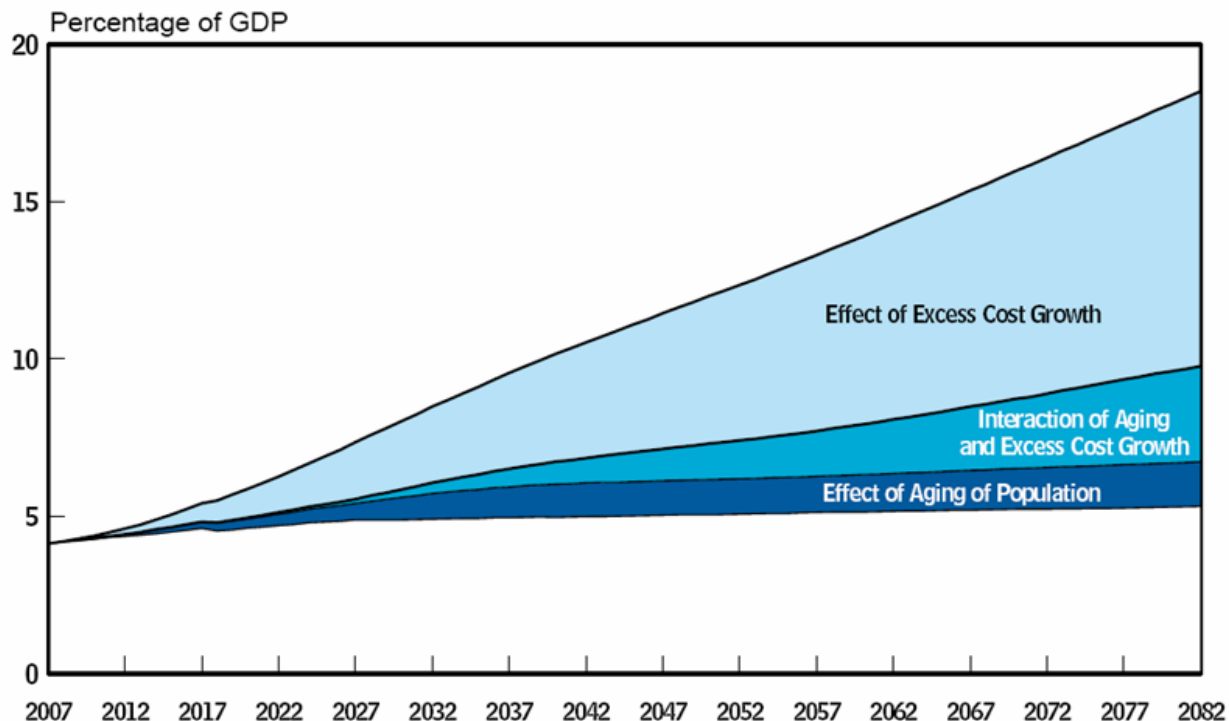
Note: The alternative fiscal scenario incorporates the assumptions that all expiring tax provisions (other than the payroll tax reduction), including those that expired at the end of December 2011, are instead extended; that the alternative minimum tax is indexed for inflation after 2011 (starting at the 2011 exemption amount); that Medicare's payment rates for physicians' services are held constant at their current level; and that the automatic enforcement procedures specified by the Budget Control Act of 2011 do not take effect. The budgetary effects under the alternative fiscal scenario also include the incremental interest costs associated with projected additional borrowing.

Source CBO: Updated Budget Projections (3/2012)



Source: Congressional Research Service RL33074

Projected Federal Spending on Medicare and Medicaid (% GDP)



- It is the *rate* of spending per individual that will have the most impact, rather than the *quantity* / demographics of an aging population.
- "Excess cost growth" refers to the extent to which the increase in health care spending for an average individual exceeds the growth in per capita GDP.
- "Interaction..." refers to effects of excess cost growth and the aging of the population, which result in greater growth in spending than would result from either factor separately.
- "Aging of population" refers to demographic shifts, such as an increasing average population age and life expectancy.

Revenue Neutral Reform

Base broadening

Tax Expenditures

Current Law vs. Current Policy Baseline

Distributionally Neutral; Progressivity

Fairness: Horizontal vs Vertical Equity

Eliminate almost all deduction and credits

Simpson-Bowles lowered income brackets to 12, 22, and 28%

Romney 20% reduction of current income tax brackets

Lower Mortgage Deduction, possibly disallow 2nd home

Make interest from State and Municipal bonds fully taxable

Consolidate tax-preferred retirement accounts

Tax capital gains (dividends) at ordinary rates, allow exclusion
keep cap gain rate = dividends?

Buffet Rule – minimum tax on high-earners

“Super Pease” – further limit deductions of high-earners

Entitlements

Provides greater benefits to lower income; smaller to upper income

Chained CPI for determining benefits growth

Gradually increase retirement age and index for longevity

Raises cap on payroll to \$170,000 (90% of wages) from \$110,100

Estate Tax Proposals

- Require 10-year minimum term for GRATs
- Require consistent estate and gift tax values for estate & heir
- Tighten rules on valuation discounts
- Democrats: 45% rate, \$3.5 million exemption

Questions?

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Additional Announcements



- **Registration for the 2013 fi360 Conference is now open!** Join us in Scottsdale, AZ April 17 - 19 and gain valuable insights from leading fiduciary experts, discuss the industry's hottest topics, and share your professional experiences with colleagues. Also be sure to check out our convenient pre-conference AIF®, AIFA® and fi360 Toolkit training events taking place April 15 – 17.
(http://www.fi360.com/main/conference_2013.jsp)
- Call for speakers! Each year, fi360 welcomes speaker proposals from qualified candidates to present fiduciary-related themes from their area of expertise or experience at our annual national conference. To be considered as a session speaker, please complete and submit the [fi360 Conference Speaker Proposal Form](#). **Deadline to submit a speaker proposal is October 19.**

Thank You



- Continuing education credit for the AIF and AIFA designations and CFP certification will be reported by fi360
- Visit the fi360 Blog for a follow-up post to answer your questions:
<http://blog.fi360.com>
- A recording of this webinar will be available soon in the archive (www.fi360.com/webinars) and in the Designee Portal
- Email resources@fi360.com with any additional questions or comments